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No. 03-1106

In the Supreme Court of the United States

FAIRFAX REALTY, INC., NORTH PLAINS LAND COMPANY, LTD., AND NORTH PLAINS DEVELOPMENT COMPANY, LTD.,

Petitioners,

v.

ARMAND L. SMITH AND VIRGINIA L. SMITH,

Respondents.

On Petition for a Writ of Certiorari to the Utah Supreme Court

REPLY BRIEF FOR PETITIONERS

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REPLY BRIEF FOR PETITIONERS

As we explained in the petition, this case is emblematic of two errors that courts have been making with regularity in addressing excessiveness challenges to punitive damages awards under the due process clause: first, dozens of courts have misconstrued *State Farm* to afford a *de facto* free pass to any punitive award that is less than ten times the plaintiff's compensatory damages; second, in applying the reprehensibility guidepost, reviewing courts repeatedly have accepted every conceivable inference that might support a finding of high reprehensibility and taken the evidence in the light most favorable to such a finding rather than conducting a *de novo* review of the facts relevant to reprehensibility.

Respondents do not deny that courts routinely have been ignoring this Court's statements about 1:1 to 3:1 ratios being "instructive" and a ratio of 1:1 possibly being the constitutional maximum when compensatory damages are "substantial." Nor do they deny that most reviewing courts have put a heavy thumb on the scale by deferring to phantom factual findings when evaluating whether a punitive award is proportionate to the degree of reprehensibility of the conduct. Instead, they try to duck the issues entirely — first, by asserting that Fairfax's specific invocation of the due process clause and citation to *BMW* in its opening brief in the Utah Supreme Court were nonetheless insufficient to preserve a constitutional excessiveness issue for review by this Court, and then by mischaracterizing our position on the ratio issue and distorting the procedural history pertinent to the standard-of-review issue. When these diversions are swept aside, it becomes clear that this case is an excellent vehicle for addressing the two critical recurring issues presented in the petition.

REPLY STATEMENT OF FACTS

There is perhaps no better demonstration of the need for *de novo* review of the evidence relevant to the reprehensibility determination than respondents' statement of facts, which is replete with inaccuracies, misstatements, and exaggerations. Although it is not necessary for this Court to resolve factual disputes at this stage of the case, we respond here to some of respondents' more egregious distortions simply to illustrate why it is constitutionally deficient for courts to apply a sufficiency-of-the-evidence standard when determining whether the degree of reprehensibility of the conduct supports the amount of the punitive award.

1. *Contribution of the Mall to the REIT.* A central theme of respondents' Opposition is that the contribution of the Mall to the REIT was a sham transaction designed to benefit John Price at the expense of the Smiths. To that end, respondents contend that Price "admitt[ed] on cross examination that a conveyance of the Mall by Price to the REIT was not a partnership purpose" (Opp. 5), that the Mall was never in financial trouble (Opp. 5-7), and that the Chemical Bank short-term loan that financed the Mall's construction "was routinely rolled with a further extension 'assumed' by Price to at least July 1994, if necessary" (Opp. 6). In fact, Price's so-called "admission" was merely an acknowledgment that, at the time the Partnerships were created in 1984, no one contemplated that the Mall would later be transferred to a REIT. Tr. 578. The need to transfer the Mall to a REIT arose only after Fairfax received a notice of default from Chemical Bank, Chemical declined to grant Fairfax an additional extension on the loan and demanded payment of the balance in full, and Fairfax consequently was faced with imminent foreclosure due to a complete lack of prospects for selling or refinancing the property and to inadequate cash flow (facts that respondents do not, and cannot, dispute). Tr. 1073, 1089, 1106-07, 1719-20,

1922-23.[1] In short, even if a jury reasonably could infer that conveyance of the property to a REIT was not a valid partnership purpose from the mere fact that Price did not anticipate in 1984 that a REIT would be necessary ten years later (which we by no means concede), the reprehensibility guidepost would be robbed of much of its constraining force if reviewing courts are permitted to uncritically accept this kind of attenuated and illogical inference as "fact."

Respondents' assertion that Fairfax conveyed the Mall to the REIT in order "to confer extraordinary monetary benefits on John Price" (Opp. 7) is equally untenable. Though they recite a laundry list of benefits that Price allegedly received as a result of the REIT transaction (Opp. 11-12), respondents do not deny that Price would have received these same benefits regardless of whether the Mall was contributed to the REIT (Tr. 1123, 1326-27) — a fact that completely undercuts the inference about Fairfax's true motivations to which they claim they are entitled. They also ignore the undeniable fact that none of the partners in any of the other malls that were contributed to the REIT complained about the transaction (Tr. 1232) — a fact that again is impossible to square with the inference that Price was engaged in self-dealing. And the only rejoinder respondents have to the undisputed testimony that Fairfax did not need the Mall in order to proceed with the REIT is a citation of the REIT's prospectus, which listed the Mall as one of the eight major regional malls included in the REIT. Opp. 7. That response misses the point. To say that the Mall was one of eight major regional malls in the REIT is not to say that the REIT could not have gone forward without it.

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[1] In what can only be characterized as a model of circularity, respondents place heavy emphasis on the fact that Chemical Bank agreed to extend the loan to July 1994. Opp. 6. It is undisputed, however, that Chemical did so ***because*** Fairfax had undertaken to organize a REIT to pay off the loan. Tr. 1075, 1175-76, 1235.

2. *The REIT value of the Mall.* As they did in the lower courts, respondents also assert vigorously that Fairfax swindled the Smiths by measuring their interest in the Partnerships by means of a "newly manufactured 'REIT value'" rather than fair market value. Opp. 9. Contrary to respondents' contention that the REIT value was "concocted" and based on "an erroneous 'backed-into' capitalization rate" (*ibid.*), however, the undisputed testimony at trial was that the REIT value used — the capitalized cash flow of each property — was recommended by the professional advising Fairfax as the only method that the market would accept for the purposes of the REIT offering. Tr. 1093-95, 1099, 1127-28, 1150, 1163-64, 1293-96.

Respondents compound this distortion by asserting that Fairfax "cooked the partnership books" by computing a March 1994 REIT value of their 15% interest in the Partnerships at 352 units (worth $6,160 at the prospectus price of $17.50 per unit) when a calculation only a few months earlier determined that respondents' interest consisted of 3,119 units (worth $54,582). Opp. 13-14. Absent from this recitation is the rest of the story: after the initial January 1994 calculation (and the day before the REIT closed), Fairfax informed Smith that he would receive 13,319 units from the REIT, worth $233,082.50 at the prospectus price. Tr. 1843, 1998. The latter figure remained constant until March, when Fairfax offered respondents 352 units in the REIT worth $6,160, plus $230,640 for respondents' capital contribution, for a total of $236,800.

Is a jury entitled to ignore these undisputed facts in determining liability for the underlying torts? Perhaps. But the purpose of *de novo* review of the *BMW* factors is to "ensure[] that an award of punitive damages is based upon an application of law, rather than a decisionmaker's caprice." *State Farm Mut. Auto. Ins. Co.* v. *Campbell*, 123 S. Ct. 1513, 1520-21 (2003) (internal quotation marks omitted). That purpose cannot be achieved if reviewing courts continue to defer blindly to

every inference urged by the plaintiff's lawyers during the course of the trial.

ARGUMENT

1. *Jurisdiction.* Respondents argue at length that this Court lacks jurisdiction because Fairfax allegedly failed to raise a federal constitutional excessiveness claim before the Utah Supreme Court. They entirely ignore, however, this Court's repeated statement that a litigant need only put the lower court on notice as to the substance of a federal constitutional claim in order to preserve that claim for review. See Pet. 2, 3. Instead, respondents assert that Fairfax failed to comply with the Utah Rules of Appellate Procedure that require a litigant to identify constitutional provisions "whose interpretation is determinative of the appeal or of central importance to the appeal," to set forth in its opening brief a statement of issues presented for review, and to brief its constitutional claim before the Utah courts. Opp. 17-19. Respondents conclude that this failure "creates an independent state procedural ground barring this Court's consideration of the newly-raised federal issue." Opp. 20.

Respondents are mistaken. To begin with, the rule requiring quotation of "[c]onstitutional provisions * * * whose interpretation is determinative of the appeal or of central importance to the appeal" (Utah R. App. P. 24(a)(6)) was inapplicable because resolution of Fairfax's constitutional excessiveness argument depends on an application of the *BMW* guideposts, not an interpretation of the due process clause (it long ago having been settled that due process prohibits grossly excessive punishments). Equally misguided is respondents' assertion that Fairfax committed a procedural default by stating in its list of issues presented that the issue was whether the punitive damages were excessive without identifying the source of law upon which it was relying. The Utah Supreme Court evidently saw that as no impediment to consideration of

Fairfax's state-law excessiveness claim, so it equally cannot be a waiver of the federal excessiveness claim.

Respondents' final preservation point (and the only one upon which the Utah Supreme Court relied) is that Fairfax "failed to brief a federal due process claim before the Utah Supreme Court," by which they mean that Fairfax did not "argue how the punitive damage judgment was 'grossly excessive' under the three factors enunciated" in *BMW*. Opp. 18. To state that argument is to refute it. As respondents acknowledge (Opp. 20), Fairfax expressly asserted that the punitive award was excessive under the *BMW* guideposts for the same reasons that it was excessive under Utah's seven-factor standard. See Pet. 2. Moreover, the Utah Supreme Court itself confirmed the validity of Fairfax's position that analysis of the *BMW* guideposts "mirrors" analysis of the Utah standards (see Pet. 2 (quoting Fairfax's opening brief)) by repeatedly citing *State Farm*, *BMW*, and this Court's other punitive damages precedents in analyzing excessiveness under Utah law. See Pet. App. 18a-19a, 21a-22a, 23a-24a.

Respondents find great significance in the fact that Fairfax raised the federal argument in a footnote on page 45 of its 50-page brief (Opp. 20-21), but that is no basis for finding a lack of jurisdiction. The bottom line is that the footnote clearly put the Utah Supreme Court on notice of Fairfax's claim and that that court refused to address the issue out of what appears to be nothing more than a desire to avoid further review.[2]

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[2] The only case respondents cite for their contention that Fairfax's footnote constituted inadequate presentation of its constitutional claim is *Adams* v. *Robertson*, 520 U.S. 83 (1997). In *Adams*, however, the petitioners had never before raised the due process argument presented in its petition for certiorari and the lower courts therefore did not even acknowledge the issue's existence. Far from supporting respondents' position, this Court's holding in *Adams* that the citation of a federal case ***for a different proposition*** was "insufficient to inform [the] state court that it has been presented with

2. *Ratio.* Respondents' only response to our contention that the cases decided since *State Farm* demonstrate the need for further guidance regarding the ratio guidepost is to mischaracterize it. Contrary to respondents' characterization (Opp. 22 (see also Opp. 23, 24, 25, 26)), we have not asked the Court to "fix a due process mathematical formula of a 1:1 ratio of punitive to compensatory damages where compensatory damages are 'substantial.'" Our petition simply asks the Court to clarify that its statements that 1:1 to 3:1 ratios are "instructive" and that a 1:1 ratio often may be the constitutional maximum when compensatory damages are substantial were not merely precatory and that it therefore is improper to treat any single-digit ratio as being presumptively permissible. Respondents do not deny that the Utah Supreme Court's decision exemplifies this misconstruction of *State Farm*. Nor do they deny that numerous other courts have made the same error. Indeed, even in the roughly six weeks since we filed the petition, courts have continued to deem a single-digit ratio to be presumptively constitutional even when the compensatory award is quite substantial.[3]

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a [federal] claim" (*id.* at 88 (internal quotation marks omitted)) compels the conclusion that Fairfax's specific reference to the due process clause and quotation of the three *BMW* guideposts was sufficient to put the Utah Supreme Court on notice of its constitutional excessiveness claim.

[3] To the list in our petition may be added *Union Pacific Railroad Co.* v. *Barber*, 2004 Ark. LEXIS 128 (Ark. Feb. 26, 2004). In holding that a roughly 5:1 multiple that yielded a $25 million punitive award was not indicative of excessiveness, the *Barber* court focused exclusively on the Court's pronouncement that single-digit multipliers are more likely to comport with due process, ignoring its statements about 1:1 to 3:1 multiples being "instructive" and 1:1 possibly being the limit when compensatory damages are substantial. *Id.* at *53-*54.

3. *Standard of Review.* In answer to our contention that review is needed to provide further guidance regarding the nature of the required *de novo* review, respondents assert that the Utah Supreme Court conducted precisely the type of review we advocate (Opp. 26-28) and that there is no "need to 'clarify' anything" because "federal and state courts understand that *de novo* review means a new review of the facts" (Opp. 28, 29). They are mistaken in both respects.

The sole basis for respondents' assertion that the Utah Supreme Court "made its own independent fact analysis" (Opp. 27) is that court's statement that it agreed with the trial court that Fairfax's "actions amount to affirmative misconduct showing deliberate misrepresentation and disregard of the rights of the Smiths" (Opp. 27-28). In fact, this citation confirms the deferential nature of the Utah Supreme Court's review, coming as it did after that court had repeatedly recited the evidence in the light most favorable to the verdict (see Pet. App. 2a, 7a, 14a) and regurgitated the trial court's special findings (*id.* at 19a) — all of which were predicated on a "substantial evidence" standard, rather than a *de novo* standard (*id.* at 35a).[4] Indeed, the Utah Supreme Court itself expressly invoked the "substantial evidence" standard when evaluating the supposed motive for Fairfax's conduct. *Id.* at 20a. By contrast, nowhere in the opinion is there any indication that the Utah Supreme Court carefully considered Fairfax's arguments as to why the evidence does not warrant a conclusion that its

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[4] Respondents take us to task for pointing out the Utah Supreme Court's observation that "[r]easonable minds could differ" as to whether respondents were injured by Fairfax's conduct, noting that the court made that statement in the course of affirming the denial of Fairfax's motion for directed verdict, which was subject to an abuse-of-discretion standard of review. Opp. 28. That criticism misses the point, which is that, because this and other issues were close ones, a true *de novo* review of the evidence may well have resulted in the conclusion that Fairfax's conduct was not sufficiently egregious to support a $5.5 million punitive award.

conduct was reprehensible enough to support a $5.5 million punishment and why the various inferences respondents had urged on the jury and repeated in their brief were unreasonable ones. See pages 2-4, *supra*.

Respondents are equally mistaken in asserting that "federal and state courts understand that *de novo* review means a new review of the facts" (Opp. 29). As demonstrated in the petition, many courts, like the Utah Supreme Court, continue to import a sufficiency-of-the-evidence standard into their application of the reprehensibility guidepost. Accordingly, review is critical to correct this serious evisceration of *de novo* review.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted.

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